

OECD CONFERENCE
Changes in Investment Environment in East
Asia affecting Overseas Investment made by
Medium & Small Enterprises

—Problems to be solved and countermeasures to be adopted
by Medium & Small Enterprises in their Overseas Direct Investment
in East Asia—

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Changes in Investment Environment in East Asia affecting Overseas Investment made by Medium & Small Enterprises

(1) **Peculiar features of Business Development made by Medium & Small Enterprises in East Asia**

Concentrated investment in China.

Shift from simple import procurement to locally based production necessitated by expanded overseas production by client companies.

(2) **Changes in Investment Environment in East Asia**

Changing business mind of Japanese enterprises towards investment into China.

Promotion of FTA (Free Trade Agreement): Reviewing of operation bases in ASEAN Countries.

Comparative analysis of investment environment in China and ASEAN Countries: Japanese firms employing a “China plus one” strategy.

(3) **Problems to be solved and countermeasures to be adopted by Medium & Small Enterprises in their Overseas Direct Investment in East Asia**

Business strategy of “Starting Small and Growing up Big”.

Investment at the initial stage: Investment for production start-up.

Investment after the production is put on track: Investment based on growth strategies.

Case Example of Countermeasure

“OTA TECHNO PARK” (Thailand)

East Asian Business Management adopted by SUNRISE INDUSTRIAL CO., LTD.

(1) Business Development in East Asia made by Medium & Small Enterprises

Locations and functions of overseas bases of Japanese medium and small enterprises

Based on their responses to a questionnaire survey exercised by JETRO in 2006

Among 236 medium and small enterprises surveyed, 66% of them engaged in business in China followed by U.S.A. (30%) and Thailand (20%): Showing high business concentration in China.

Figure 1: Location and function of overseas business bases (of Japanese medium and small companies).

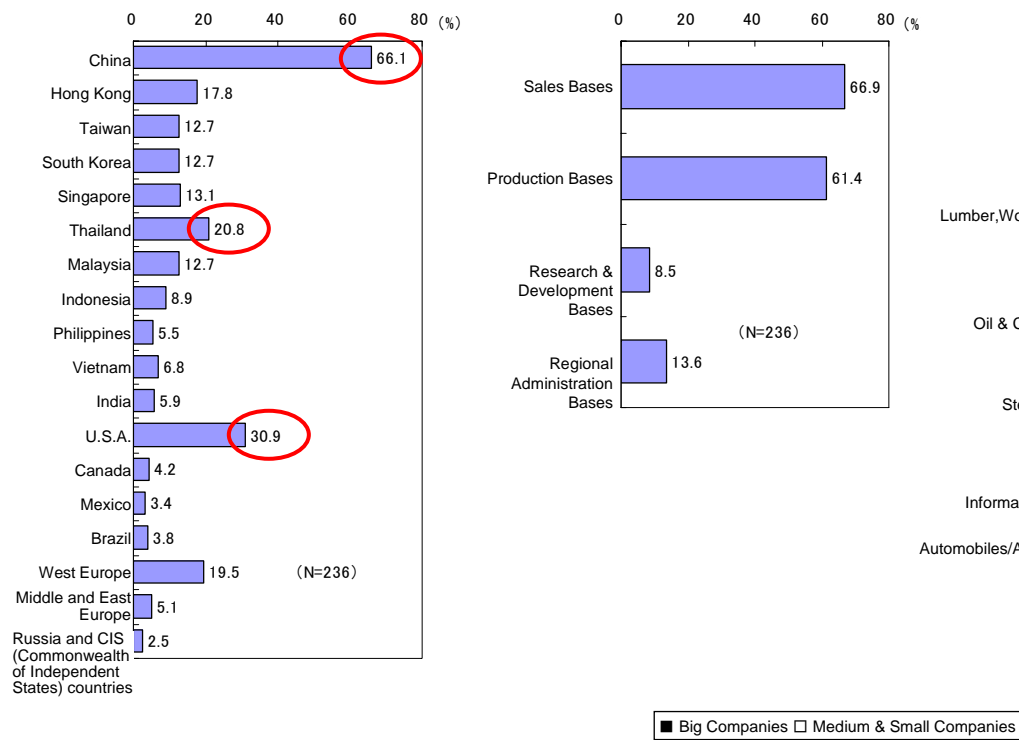
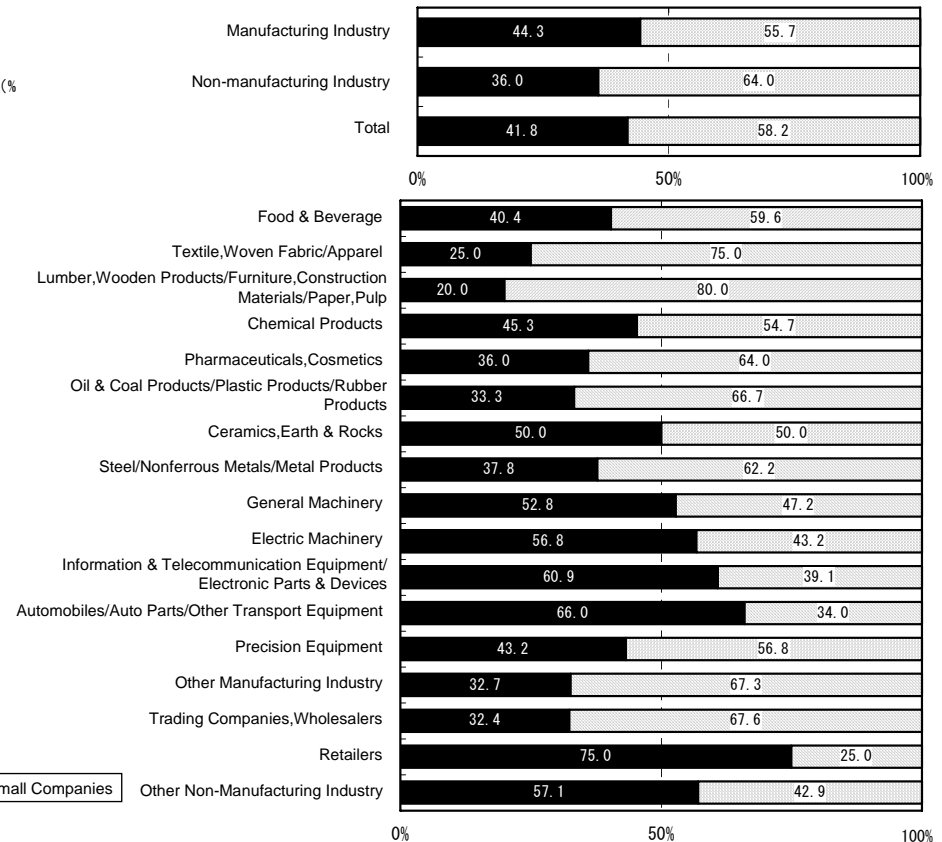


Figure 2: Distribution of Big and Medium-to-Small-sized companies (by industrial classification)



(Note) Population parameters (n) are different depending upon respective industries. Refer Figure I-8 for parameters (number of companies).

Changes in the objective of East Asian Business

Shifting from the objective of securing local procurement base to that of self-determined local production for responding positively to major clients' request

Objective of East Asian investment by Japanese Medium & Small Companies

China: 1) Securing procurement source, 2) Cultivation of market, 3) Responding to major clients' request

South East Asia: 1) Responding to major clients' request, 2) Cultivation of market, 3) Securing procurement source

Figure 3

	China	NIEs	South East Asia	North America・Europe
Cost reduction through import of cheap products	66.7	61.8	46.2	17.3
Expansion of sales channel into overseas markets	41.8	46.1	48.7	67.9
Responding to major clients' request	40.4	32.6	50.8	43.2
Securing labor force engaged in production line	17.5	12.4	10.7	1.2
Acquiring income from dividend or royalty	9.1	7.9	12.2	11.1
Effective overseas use of idle capacity	8.1	5.6	5.1	2.5
Acquiring high technological ability of foreign countries	1.1	1.1	0.0	8.6

(Source) Japan Small Business Research Institute・Independent Administrative Entity for Business and Industrial Research, *Actual Condition Survey on Overseas Business Activity of Medium & Small Companies* (November 2003)

From now on, the primary objective of overseas investment by Japanese Medium & Small Companies will be to assist their major clients in their expanding overseas production, which is especially required for automobile industry.

Figure 4: Initial objective of setting up Production Base in East Asia (by chronological order)

(Unit: %)

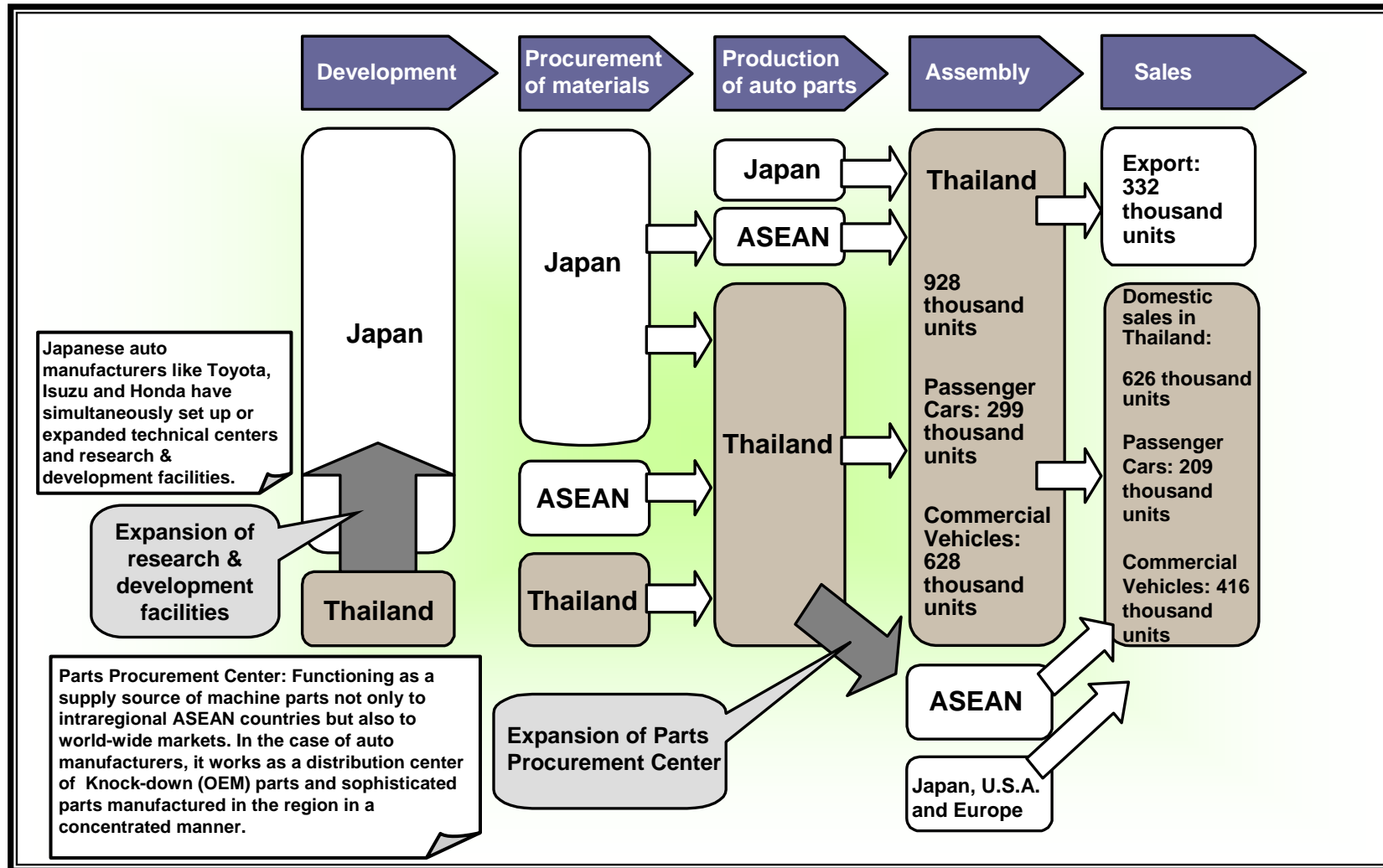
	Cost reduction (including use of cheap labor)	Responding to client's request	Self-determined adherence to overseas business expansion by major clients	Cultivation of local markets	Others
On or prior to 1985	35.0	17.5	12.5	30.0	5.0
1986-1990	60.0	14.5	7.3	12.7	5.5
1991-1995	50.0	15.0	18.0	11.0	6.0
1996-2000	38.2	22.7	22.7	9.1	7.3
2001 onward	33.1	20.4	22.1	14.9	9.4

Reference: Mitsubishi UFJ Research & Consulting Co., Ltd. "Questionnaire Survey on the Recent Changes of Business Environment surrounding Manufacturing Industry" (November 2005)

Evolution of Japanese Automobile Industry in East Asia

Thailand has become a production and product-development base of pick-up trucks

(Development, Production and Export Sales of Automobiles in Thailand for the year 2004)

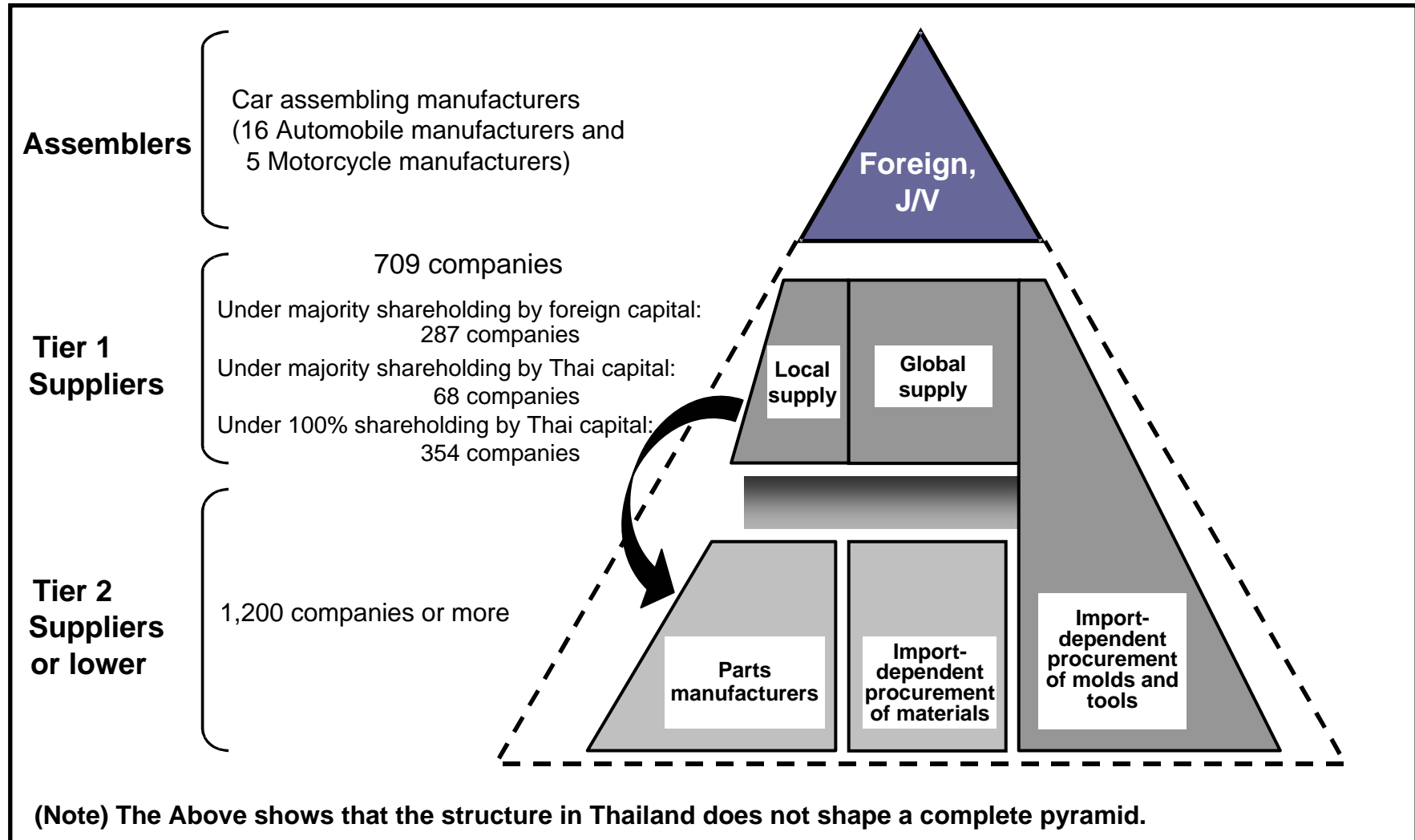


Reference: JETRO White Paper in International trade and FDI, 2004

Structure of Car Manufacturing in Thailand

Current situation and problems of local suppliers

Figure 5



Reference: Prepared by the author from information materials issued by Thai Automobile Institute, Thai Auto Parts Industrial Association etc.

(2) Changes in the Investment Environment of East Asia

Changes in Business Environment of East Asia

- 1) Potential risks in developing business activities in China
Rising wages, Currency revaluation pressure against Chinese Yuan, Abolishment of preferential treatment policy in favor of foreign capital etc.
- 2) Growing trend of Free Trade Agreement (FTA) between East Asian countries
Move towards wider regional economic integration by making ASEAN as its driving force, Abolishment of Tariff and Non-tariff Barriers
- 3) In addition to the above, growing market presence of East Asian enterprises, Increasing investment by European and American enterprises etc.

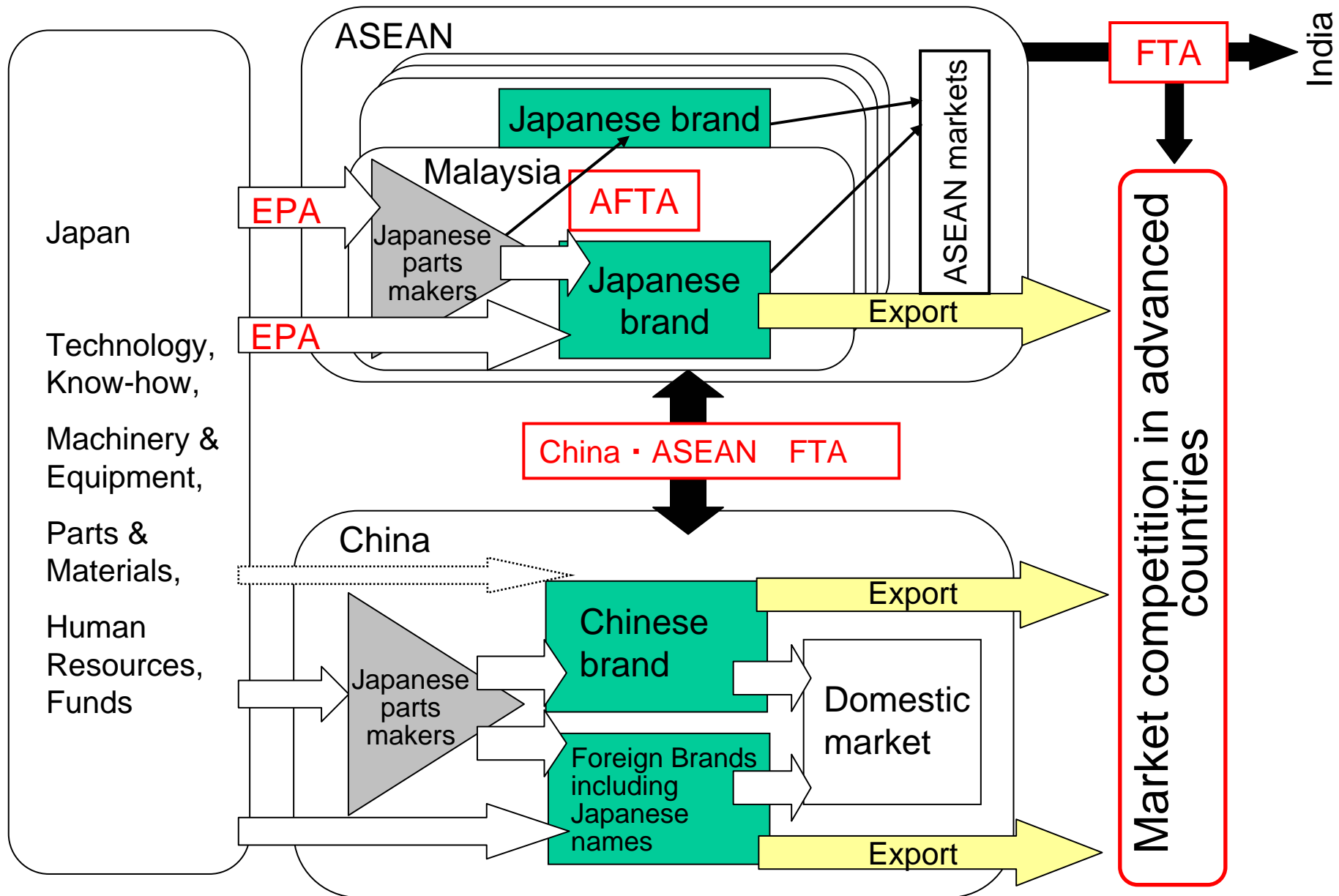
Conceivable effects created by the changes in business environment

- Would there be a change in the mood of China Concentration?
- Would there be a change in production and procurement strategies adopted by brand manufacturers?

Production and Procurement Strategies adopted by Japanese enterprises

- 1) In large companies, the concept of “China plus one” strategy is commonly established.
What is the additional one? ...It could be Vietnam, Thailand, or India etc.
- 2) Advantageous position of ASEAN countries in terms of production base in East Asia: Export base towards off-shore markets.
- 3) Japan as a production base: Regressive move into Japanese production
⇒“China plus one” strategy starts infiltrating even in medium & small enterprises

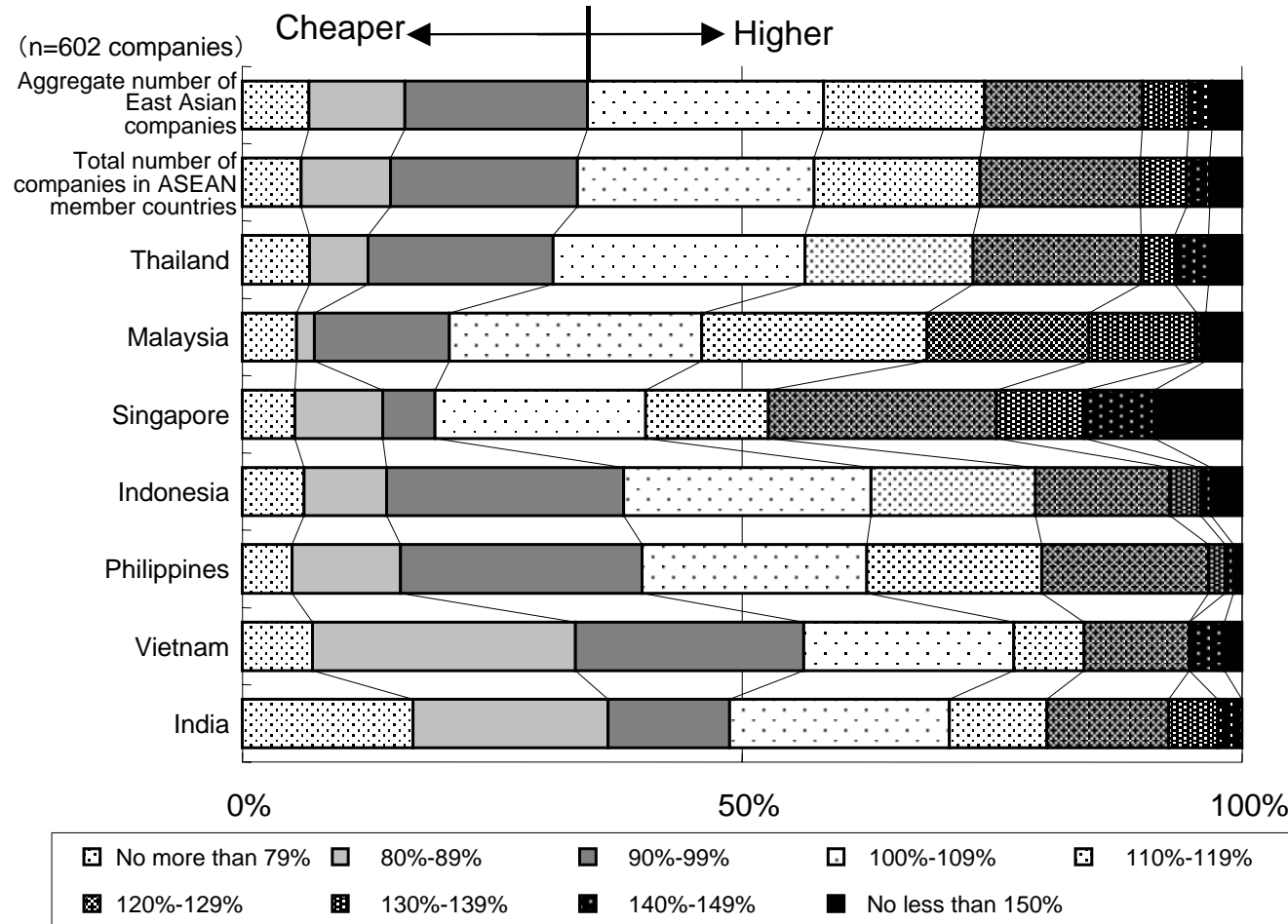
Changes in the Investment Environment of East Asia: Influence of FTA



China and ASEAN member countries 1)

—Absolute number of Vietnamese manufacturers have cost advantage against Chinese manufacturers—

Figure 6: Comparison of China and ASEAN member countries in terms of production cost



- Results of questionnaires circulated towards companies that have Chinese subsidiaries producing their typical item of products revealed that 65.5% of the total number of companies surveyed responded that “Production cost in China is more advantageous than ASEAN countries as a whole in terms of comparative cost index (more than 100% when compared with that of China being 100%)”.
- Despite the foregoing, 34.5% of those surveyed responded that ASEAN member countries and India as a whole had greater cost advantage against China in terms of production cost. In particular, 40 to 60% of those surveyed responded that the index was less than 100% in India, Vietnam and Philippines.

It can be said that Chinese advantage in terms of production cost is fading.

(Note) Comparative index of production cost in ASEAN member countries and India is calculated by making that of China being 100%. When the index is less than 100%, it signifies that the country or region has greater cost advantage against China.

“Production cost” shall mean costs incurred at factory or production site (= Cost of Materials + Labor Cost + Direct Expenses + Factory Overhead)

(Source) *Current Shape of Local Management in Japanese Manufacturing Industries operating in Asia in the year of 2005—ASEAN & India Edition* (Published by JETRO in March 2006)

China and ASEAN member countries 2)

—Prominent Chinese Superiority in the development of Supporting Industries—

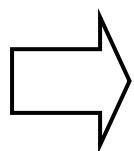
Figure 7: Investment Environment in ASEAN member countries when compared with that in China

Evaluation Item	Overall Total	ASEAN Countries Total							India
			Thailand	Malaysia	Singapore	Indonesia	Philippines	Vietnam	
Political and Social Stability	48.0	47.9	90.8	84.8	95.7	(22.7)	(17.4)	73.8	50.0
Communication Ability of Employees	43.6	41.7	34.6	52.7	88.2	(7.4)	63.0	20.3	71.8
Transparency of Investment-related Legislative Measures	37.6	38.6	68.9	66.1	92.6	(17.2)	10.3	6.9	22.5
Tax System	28.8	31.6	50.4	61.7	97.1	(35.2)	9.6	7.0	(13.2)
Infrastructure Building	1.8	7.4	64.5	67.0	95.6	(59.8)	64.7	(74.6)	(77.5)
Customs Clearance Procedures	29.9	34.6	42.0	64.2	95.6	(14.4)	22.6	(7.0)	(40.5)
Protection of Intellectual Property Rights	23.9	22.8	34.2	38.5	94.1	(12.1)	(1.8)	(6.9)	39.5

(Note) Evaluation indexes of the respective countries are calculated by deducting the percentage of companies admitting comparative inferiority of their own countries against China in terms of investment environment from the percentage of companies claiming comparative superiority of their own country against China. When the investment environment of their own country is considered superior against that of China, calculation of evaluation index shows positive balance (maximum 100) and, if considered inferior, it shows negative balance (minimum-100).

This questionnaire was responded by Japanese companies having some kind of operation bases in ASEAN member countries and India.

(Source) *Actual Status of Local Management in Japanese Manufacturing Industries operating in Asia in the year of 2005 – ASEAN & India Edition*
(Published by JETRO in March 2006)



China is considered to have comparative superiority against ASEAN member countries and India in terms of Development Status of Supporting Industries and Skill level of Researchers and Engineers.

Comparison of Investment Environment in East Asia From JETRO Survey for the year 2006 (Responded by Medium and Small Companies)

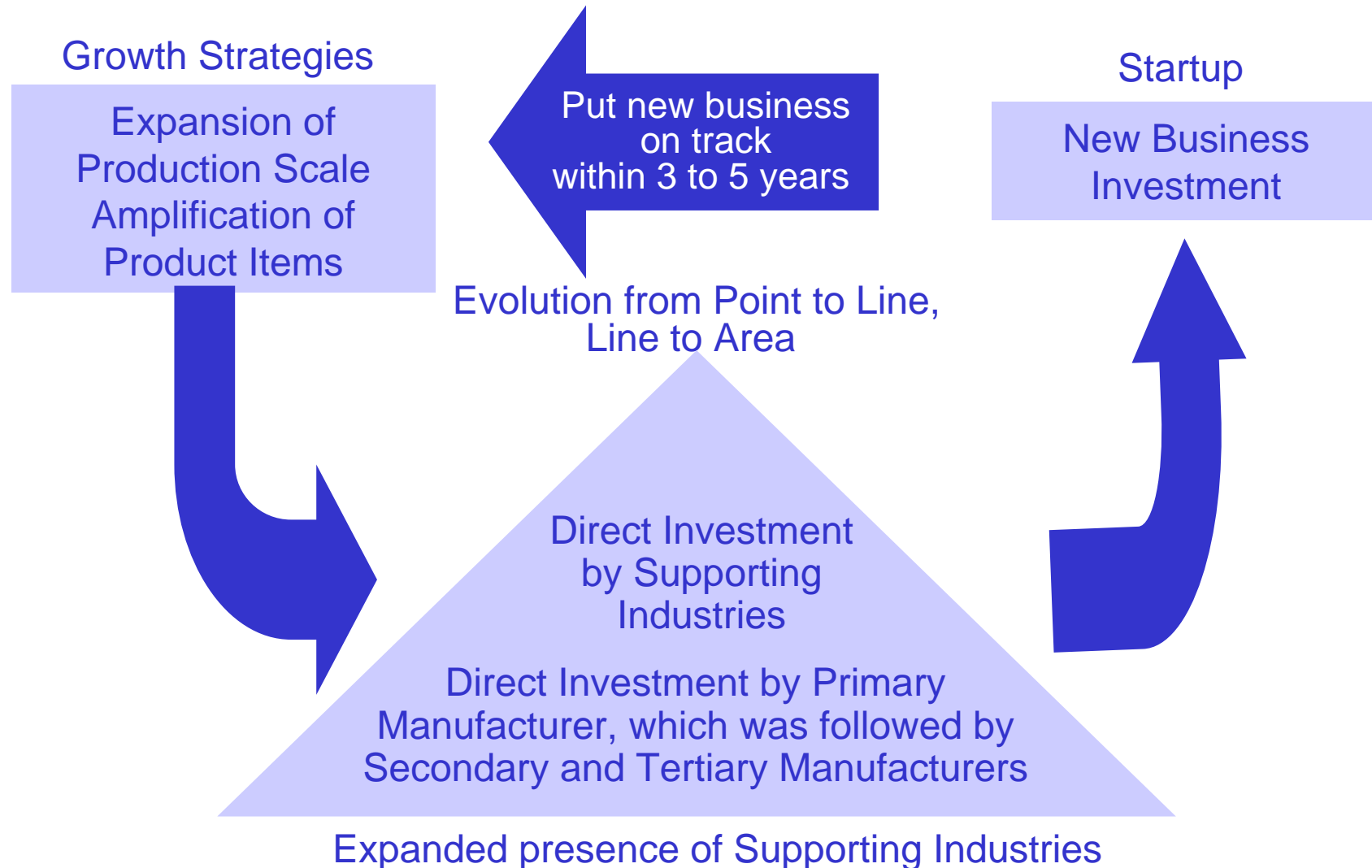
Figure 8

(Number of Respondent Companies, in %)

	Total number of companies considering expansion of existing business or launching new business in the respective Asian countries (Number of companies)	Political and/or Social Instability	High Currency Rate Fluctuation Risk	Underdeveloped Infrastructure	Insufficient Legal System and Inappropriate Legislative Measures	Insufficient Accumulation and Development of Supporting Industries	Problematic Interpretation on Protection of Intelligent Property Rights	High or Rising Personnel Expenses	High or Problematic Taxation Risks
China	311	42.4	17.0	23.2	57.6	5.8	56.3	23.8	31.5
Thailand	150	28.7	8.7	8.0	5.3	6.7	5.3	20.0	7.3
Indonesia	94	45.7	18.1	33.0	30.9	12.8	11.7	6.4	14.9
Malaysia	102	2.0	5.9	5.9	5.9	11.8	2.9	16.7	6.9
Philippines	68	51.5	8.8	33.8	13.2	23.5	8.8	7.4	8.8
Singapore	99	1.0	1.0	-	-	3.0	2.0	38.4	2.0
Vietnam	98	11.2	8.2	48.0	33.7	24.5	8.2	7.1	6.1
India	87	12.6	5.7	55.2	32.2	16.1	12.6	4.6	11.5

(3) Problems to be solved and countermeasures to be adopted by Medium & Small Enterprises in their Overseas Direct Investment in East Asia

For realizing the business strategy of “Starting Small and Growing up Big”



Problems to be solved and countermeasures to be adopted by Medium & Small Enterprises in their Overseas Direct Investment in East Asia ...Initial Investment Stage

1) Peculiar features in the Initial Investment Stage

- Business Strategy of “Starting Small and Growing up Big”
...due to Limited Financial, Human and Information Resources
- Need for long lead time before production is put on track
...due to Time-consuming technical guidance
- Mostly Japan-based Customers
...due to weak capability in sales and collection of receivables

⇒ Small size of Investment

Factory construction in the initial stage does not require spacious land. Therefore, more-than-immediately-needed space of land is normally acquired (in the case of investment in China, it normally extends 1,000 square meters).

⇒ Although depending upon budgeted investment cost, more companies tend to set up their factories in Privileged Industrial Parks in recent years.

Although relatively expensive in running cost, investing companies can normally enjoy attentive services and well-equipped infrastructure in Privileged Industrial Parks.

⇒ The greatest concern is focused on production. (see Figure 9)

Establishment of “OTA TECHNO PARK” in Thailand

Problems to be solved and countermeasures to be adopted by Medium & Small Enterprises in their Overseas Direct Investment in East Asia

...Problems in the Initial Investment Stage

Figure 9: Managerial problems faced by Medium and Small Companies operating abroad
(with respect to such companies that made initial investment in the year 2005)

(Unit: number of cases, %)

Problems	Region		ASEAN		Total	
	China	Ratio	ASEAN	Ratio	Total	Ratio
Education and Training of Local Employees	37	46.8	9	52.9	56	46.7
Procurement of Parts and Materials	23	29.1	3	17.6	29	24.2
Productivity of Local Factories	19	24.1	3	17.6	27	22.5
Cultural or Conventional Differences	23	29.1	1	5.9	27	22.5
Frequent changes in Administrative System and Policies	19	24.1	0	0.0	21	17.5
Currency Rate Fluctuation	14	17.7	1	5.9	19	15.8
Fund Procurement	12	15.2	3	17.6	16	13.3
Securing Local Manpower	8	10.1	1	5.9	26	12.5
Rising Personnel Cost	12	15.2	1	5.9	14	11.7
Underdeveloped Infrastructure	10	12.7	3	17.6	14	11.7
Others	8	10.1	2	11.8	14	11.7
Selection of Temporary Staff	7	8.9	2	11.8	13	10.8
Incomplete Legal System	11	13.9	0	0.0	12	10.0
Unstable Political Climate and Security Situation	10	12.7	2	11.8	12	10.0
Collection of Receivables	9	11.4	0	0.0	10	8.3
Sluggish Sales	2	2.5	1	5.9	7	5.8
Relationship with Business Partners	4	5.1	1	5.9	5	4.2
Number of companies responded to questionnaires	79	100.0	17	100.0	120	100.0
(Ratio of Respondents)	(98.8)		(89.5)		(95.2)	
Number of investing companies	80		19		126	

(Remarks) Plural number of responses permissible, Ratio=Number of responses/Number of companies responded (Number of companies responded to this particular questionnaire item), Ratio of Respondents=Number of companies responded to questionnaires/Number of companies operating locally

(Source) *Survey on Overseas Direct Investment made by customers of Cooperative Banks for the year 2005* published by SHINKIN CENTRAL BANK in March 2006

Establishment of a Collective Industrial Complex called “OTA TECHNO PARK” destined for the use of medium and small companies under the initiative of district administrative body of OTA Ward

Opened in June 2006

- ◆ The collective industrial complex called “OTA TECHNO PARK” established in Amata Nakorn Industrial Estate (Chonburi Prefecture) under the initiative of district administrative body of Ota Ward became rentable as from June 26, 2006.
- ◆ The realization of “OTA TECHNO PARK” is a successful example of beneficial interest sharing between OTA Ward wishing to assist overseas direct investment by its resident enterprises on one hand, and the Thai administration hoping to absorb basic technologies developed and accumulated by medium and small enterprises based in OTA Ward on the other.
- ◆ It provides a number of privileged treatments in favor of tenant companies that include comprehensive clerical support by local administration staff for example.

Background of Establishment

- ◆ In July 2005, a Memorandum of Understanding was signed between Ota City Industrial Promotion Organization and a Thai industrial estate developer called AMATA CORPORATION for the purpose of establishing collaborative industrial relationship between the two parties.

Features of “OTA TECHNO PARK”

- 1) Floor Space: No less than 320 m² per rental unit is allocated for the use of medium and small companies (Total number of units: 8 units)
- 2) Parking Space and Telephone Lines: Accommodation of parking space for minimum 2 cars and 3 telephone lines per rental unit
- 3) Applicable Rent for tenants: It was set as J.Yen 600 per 1 m²
- 4) Facilities for Communal Use: Reception, Conference Room, Security Installation etc.
- 5) Assistance Service: Continuous presence of Japanese-speaking Thai staff who provides a comprehensive assistance service concerning general affairs that includes administrative procedures for BOI, company registration, taxation and labor matters.

Fees and Charges

- 1) Rental Fee for Factory Space: About J.Yen 200,000 per rental unit (320m²)
 - 2) Office Charges: About J.Yen 100,000 per rental unit
- *Guaranty Deposit: Equivalent to 4 months rental fee (J.Yen 800,000)

AMATA NAKORN Industrial Estate

- The largest industrial estate located about one hour driving distance southeast to Bangkok.
- Among approximately 380 tenant companies, 70% of them are Japanese-affiliated companies mainly composed of automobile and electric appliance-related industries.



Imaginary illustration of OTA TECHNOPARK to be completed in June 2006
(with Factory Building at the back, Administration Building in front)



(Source) Prepared by Mr. Sukegawa of JETRO Overseas Research Department

Problems to be solved and countermeasures to be adopted by Medium & Small Enterprises in their Overseas Direct Investment in East Asia

...Problems in the second and third stage: Managerial Tasks

- 2) Next steps to be taken after production is put on track ... Production Expansion, Cost Reduction, Expansion Investment, Amplification of Product Line (High Value-added Items)
Expansion of Sales Network into such new market areas that include Japanese affiliated companies of no previous transaction record, local enterprises, European and American manufacturers
Fostering Human Resources ... Selection of talented local manpower
Procurement of materials from local industries, Excavation of reliable consignment production partners
- 3) Need for addressing a move towards localized product development by brand manufacturers

Figure 10: Functions that shall be expanded through overseas production

(Plural number of responses, %)

	Number of companies	Sales Function	Production Function (in ordinary products)	Production Function (in high-value-added products)	Research & Development Function (in developing new products)	Research & Development Function (in changing product specification for local markets)	Regional Administrative Function	Logistical Function	Other Functions
Total	477	77.4	49.9	32.9	14.9	17.6	15.1	18.9	1.9
Large companies	237	80.6	57.0	36.7	16.9	19.4	21.1	21.5	2.5
Medium and small companies	240	74.2	42.9	29.2	12.9	15.8	9.2	16.3	1.3
Manufacturing Industry	359	75.8	59.3	36.5	16.4	21.4	17.0	18.1	1.4
Overseas manufacturing industry	263	73.0	69.6	43.7	19.4	25.5	19.0	19.8	1.1
Domestic manufacturing industry	96	83.3	31.3	16.7	8.3	10.4	11.5	13.5	2.1
Non-manufacturing Industry	118	82.2	21.2	22.0	10.2	5.9	9.3	21.2	3.4

Problems to be solved and countermeasures to be adopted by Medium & Small Enterprises in their Overseas Direct Investment in East Asia

...Problems in the second stage: A case example of Japanese-affiliated
medium and small companies operating in China

- 1) At the time of initial direct investment in China by medium and small companies, their business objectives were re-import of finished products into Japanese market and performing supplier function in favor of Japanese component manufacturers operating locally. In such sense, sales channels of their products were guaranteed.
- 2) However, in later stage, aggressive headhunting of Japanese engineers and active introduction of high-performance machinery by local manufacturers resulted in increasing their price competitiveness and improving their product quality.
- 3) As a result, purchase order from locally operating Japanese component manufacturers tended to decrease due to their direct procurement from local Chinese manufacturers.
- 4) So as to cope with the problem, locally operating Japanese manufacturers started to focus their efforts on development of new sales channels (including domestic sales and export to third countries), upgrading their productivity (through enhanced capital investment for increasing production capacity and fostering talented human resources), and active procurement of parts from local industries.

Countermeasures to be adopted by Medium & Small Enterprises:

Medium & Small Enterprises operating in China are currently facing with such managerial problems as growing trend of Job-hunting by employees, outflow of technological expertise, increasing risk in protecting their intellectual property rights, difficulty in selecting talented local manpower, and additional need for improving product quality.

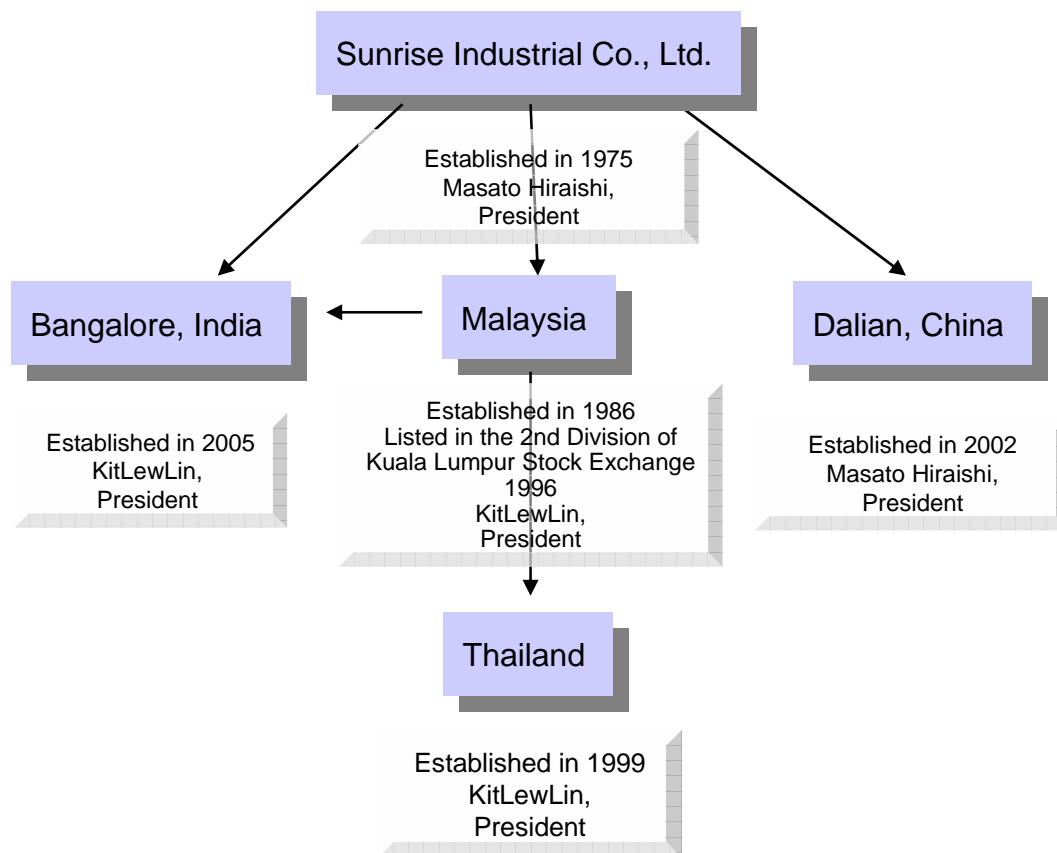
⇒ The key to success in solving the managerial problems rests on how to make differentiation from other competitors.

Business Management of Medium and Small Enterprises operating in East Asia

SUNRISE INDUSTRIAL CO.,LTD.

Figure 11

Product Item: Metal fitting for Car Cooler Hose



Reference: *Innovation and Business Growth in Japanese Medium and Small Companies* by Susumu Sanbonmatsu

Sales in the year 2005 (in million yen)

Domestic Sales: 9,942
Overseas Sales: 5,086

Federal-type Management System

Responsibility of product supply is shared geographically by the Head office and overseas subsidiaries, whereby the Head Office is responsible for domestic market and each subsidiary is responsible for the respective overseas markets where it is located.

Management of Asia-based Subsidiaries

Japanese staff is responsible for Local Business Promotion of Japanese-affiliated Enterprises and Production System Control, while Overall Local Administration is controlled by local directors including Malaysian officers. In addition to the foregoing, Pan-Asian Management Conference is held once a year in the Head Office.

Development of Human Resources and Professional Training

The goal of human resource development is to bring up 7 to 8 English-speaking local officers and 2 to 3 Chinese-speaking officers. For such objective, it is planned to recruit 2 to 3 new graduates from Chinese and Thai universities respectively in every year and give them fundamental management and business control lessons in the Head Office for assigning them to the key post in overseas factories located in the respective Asian countries.

Countermeasures to be adopted by Medium & Small Enterprises for solving managerial problems arising from their Overseas Direct Investment in East Asia

1) Initial Direct Investment: How to prepare for smooth setup?

Individual support and assistance given by customers

Support and assistance offered by investor-side government.

Support and assistance accorded by public institutions including JETRO

Providing investment-related information service and advices: JETRO Support Scheme (Example: Business Support Center=BSC)

Regional Cluster Support: Presentation at the Exhibition, Detachment of Mission

2) Measures and dispositions accommodated by investee-side government.

Facilitating communication between public institutions and regional clusters of two countries.

Simplifying investment procedures: One-stop Service

Amplifying support services available for medium and small enterprises investing in industrial estates: Although they shall be proportionate to cost of investment

Supplying corporate information on local enterprises (Procurement source of materials, Candidates for contract manufacturing): Providing corporate data, Organizing trade fairs

Institution of promotional measures for developing supporting industries: Deregulation of supporting services available for manufacturing industries

3) How to promote autonomous management: Promotion of Growth Strategy and Localization Policy

Expansion of Business Network: Outstanding technological capability is required for differentiating investing companies from local manufacturers,

Development of local human resources: Securing talented human resources for the position of middle management and technological experts.

Localization of Fund Procurement: Listing to local capital market shall also be brought into view.

Localization of Product development: Transfer of Japanese Function and Know-how shall be studied.

Excavation and training of local manufacturers.